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SUBJECT: KARELIA: STRIVING FOR ECONOMIC AND POLITICAL STABILITY

REF: ST. PETERSBURG 0008

11. (SBU) Summary: Worsening economic conditions and the uncertain prospects of recovery dominated the Consul General's meetings in Petrozavodsk. Local officials and business people are skeptical that the regional administration can solve the problems of the export-oriented Karelian economy, and are counting on worldwide recovery to help restore growth. With growing evidence of declining living standards, the government of Karelia is anxious to maintain political stability and prevent protest rallies. Economic and social woes will likely be major themes in Petrozavodsk's spring mayoral elections, and endemic corruption undermines reform. End Summary.

Karelian Government Pessimistic about the Region's Economy

12. (SBU) Consul General Gwaltney's visit to the Karelian Republic's capital Petrozavodsk on March 3rd-4th revealed Karelian officials' serious concern over the economic difficulties the region is facing. According to Governor Sergey Katanandov, 2007 was successful for Karelia, and the years 2008 and 2009 might have been even more successful if the Karelian economy had not suffered damage from the world economic crisis. Katanandov stressed that Karelia's economy was export oriented, and that shrinking world markets have caused difficult times for local businesses such as saw-mills and pulp and paper plants. According to Katanandov, unemployment assistance applications have grown by 40%. Although the official unemployment level is just 3%, 15% to 20% of Karelians are estimated to have incomes below the minimum wage. Katanandov said he was troubled that these numbers could increase, and was uncertain as to what his government could do to improve the situation, given its limited resources. He doubts that Karelia will receive all of the federal financial assistance that it had expected. Katanandov said that he will reduce government expenditures by at least 10% in 2009, but do his utmost to avoid personnel retrenchment. This approach of reducing funding for programs but not personnel costs was confirmed separately by lower-level officials. Overall, Katanandov said that although the economic situation has stabilized somewhat recently, he fears that the next waves of the crisis will bring greater economic hardship.

13. (SBU) Nikolay Lyovin, the Speaker of Karelian Legislative Assembly, also noted the deleterious impact of the sharp decrease in exports, citing the demise of a U.S.-owned local business. Pegas was a profitable, American-owned, manufacturer of timber products for the U.S. home building industry. However, in 2008, American home builders' demand for Karelian timber plummeted, and the company halted production for eight months. It was eventually sold to Russian owners, but the new owners have still not been able to fully restore the business even after refocusing on sales to domestic customers. Karelian mining and construction material industries are also in decline because of reduced market demand. Lyovin added that although the volume of industrial production in Karelia is stabilizing, local industries have been unable to return to their previous levels of profitability.

Economic Recovery Dependent on U.S. and World Economic Situation

14. (SBU). Karelian officials are pinning their hopes for their own economic recovery on the new U.S. administration and on the recovery of world markets. Katanandov stressed that improvement of the U.S. economy would certainly ease problems for other countries and regions, including Russia and Karelia. He also hopes for new foreign investments in the local economy, particularly in the forestry sector. Lyovin believes that measures taken by the Russian and Karelian governments to shore up the economy will have limited effect. For example, the Russian government relented on its planned increase in customs fees for timber exports, which was helpful for Karelia, but local businesses still suffer from losses due to the reduced international demand for timber.

Political Stability: The Government's Top Priority

15. (SBU) The government of Karelia is concerned with the possible political consequences of worsening economic conditions and considers maintaining political stability to be its main objective. Katanandov claimed that the citizens of Karelia fail to understand the causes of the economic problems, and the government has had to educate its citizenry and explain its vision and policies to avoid discontent. Officials are conducting outreach with industrial workers at their places of work and with residents of Petrozavodsk and other cities in order to prepare them for a possible decline in their living standards. However, Katanandov insists that although the challenge to educate and pacify the public is great, in general the citizens of Karelia trust the government. Regarding citizens who protest the government's policies, Katanandov opined that "people should mind their business rather than attend street rallies, which are useless", although he did concede that Russian law does permit such political rallies.

Petrozavodsk: Economic and Political Problems Together

16. (SBU) Like Governor Katanandov and Speaker Lyovin, Acting Petrozavodsk Mayor Anatoliy Buldakov expressed his concern with the economy. Buldakov assumed the duties of acting mayor in January after Mayor Viktor Maslyakov's abrupt resignation. According to Buldakov, Petrozavodsk thus far has not suffered any serious harm from the economic crisis, but acknowledges there are troublesome indicators. For example, the number of officially registered unemployed individuals grew by 300-400 persons this year compared to the last year, although the overall official unemployment level in Petrozavodsk is still just 1.25%. He and others in Karelia attributed some of this increase to hidden unemployment, with people whose unemployed status predates the crisis now applying in response to the increase in unemployment benefits. Also, local companies are facing twin problems of sharp hikes in energy prices plus falling demand for their products.

17. (SBU) People's concerns about economic conditions are likely to dominate Petrozavodsk's upcoming early mayoral elections. No date has yet been set to fill the slot vacated unexpectedly by former Mayor Maslyakov (reftel). The elections must be held no later than June 7th, and the City Council is expected to determine the date soon. Since the opposition (a disparate grouping of A Just Russia, Yabloko, Communists, and independents, and all of whom are opposed to United Russia) holds a majority on the Petrozavodsk City Council, the election has the potential for becoming competitive. Governor Katanandov and Speaker Lyovin both belong to United Russia, and Lyovin is considered the likely pro-government mayoral candidate whom Katanandov, who was Petrozavodsk Mayor during the mid-1990s, will support. Acting Mayor Buldakov, who is reportedly unwilling to run for mayor, believes that the major election themes will be economic stability, social security, jobs, and routine city issues such as street cleaning, snow removal, and public transportation. He expects candidates from both United Russia and opposition Just Russia to run. A local political

analyst stated that while A Just Russia has a well-established party organization in Karelia, the other opposition forces were built by local business figures who were more concerned with their own business projects than with political and social issues of public significance. As a result, the analyst believes that United Russia will likely defeat a divided opposition.

Governor and NGOs: Disconnect on Corruption

18. (SBU) The Karelian opposition has been accusing Governor Katanandov of corruption for years. Katanandov, naturally, fiercely denies corruption accusations against both himself and his government. In fact, Katanandov grumbled to us about the poor work habits and petty corruption of the bureaucracy whose members would not accept responsibility, act transparently or seize initiative in the course of their duties. According to him, local businesses are accustomed to bribing officials as the only way to get things done. As a result, many young people in the region now prefer to become bureaucrats rather than businessmen as a more lucrative career option. Katanandov distinguishes between the low quality of public services (which he admits is serious, widespread and hard to resolve) and apparent corruption (which he asserted was quite limited in Karelia). Moreover, Katanandov alleges that whatever corruption there is can be effectively uprooted within a few years through the criminal court system, and he praised President Medvedev's anti-corruption initiatives to bolster the judiciary.

19. (SBU) The Karelian opposition and non-government sector, however, are skeptical about the government's claims regarding the low level of corruption, insisting that corruption is pervasive within the government of the Republic. According to research conducted by a local NGO in cooperation with sociologists from a local university, Karelians are accustomed to corruption. In fact, many people believe that corruption is not evil because it gives people a chance to expedite their dealings with the government and to effectively influence the decision-making process. The research shows that respondents rank law enforcement agencies, military recruitment offices, and the Karelian government as the most corrupt entities. However, more highly-educated respondents and those occupying managerial positions name the government as the primary source of corruption in Karelia. The independent survey conducted on corruption is noteworthy in two additional aspects. One, it is posted on the NGO's website and two, the Karelian Government asked for a copy of it.

110. (SBU) Comment: Like the rest of Russia, Karelia has fallen on very hard times. Major enterprises had not yet been updated or modernized before the economic downturn. The double effect of aging infrastructure and technology, plus sharply rising energy costs and credit shortages, has compounded the republic's economic woes. The problems are further complicated, as Katanandov told us, by the fact that the financial benefits of Russia's oil wealth began to flow to the region only in 2007. Karelia had hoped the next few years would help it catch up with more prosperous areas of Russia. Now the wait will be much longer. End comment.

GWALTNEY